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In the
Supreme Court of the United States

October Term, 1965

No. 408

JOHN B. JANIGAN,
PETITIONER,

v.

FREDERICK B. TAYLOR, ET AL.,
RESPONDENTS.

BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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This brief is filed by respondents in opposition to the petition of John B. Janigan for writ of certiorari to review the judgment of the Court of Appeals for the First Circuit.

Counterstatement of the Case

The only intricate question in this case was an issue of fact as to whether the plaintiff had committed fraud, and this question was resolved below after a lengthy trial with conflicting testimony and a detailed examination of corporate records and accounting practices. The trial judge found direct, material fraud, and the Court of Appeals affirmed the finding.

Once given this finding, the applicable legal principles are familiar and well settled.

The facts are as follows.

On December 27, 1955, John B. Janigan, president of Boston Electro Steel Casting, Inc., offered to purchase the common stock of the company from all of its stockholders for $20 per share.

During the three years prior to his offer Janigan had become, except for the annual audit, the sole conduit of information to the Board of Directors and thus to the stockholders. (R. 187-189, 75-78, 387-388, 403-416). The evidence showed and the trial court found that the directors to whom Janigan's offer was communicated "had every reason to repose, and did repose, trust and confidence in the truth of factual representations made by him" about the condition of Boston Electro. (R. 36, 851, 189, 75-78, 387-388, 403-416, 869-935, 84, 40-41).

At the meeting of December 27, 1955, at which Janigan made his offer to buy the stock of the company, Janigan was asked by one of the directors whether he knew of any change in the affairs of the company. He replied that there had been none. This conversation was the subject of testimony by four plaintiff-directors, was admitted by Janigan both on deposition and at the trial, and was treated at the meeting of December 27 as germane to the vote of the directors. (R. 88-92, 138-139, 195-196, 474, 480-481, 499, 609, 708-709, 732-734, 755, 962).

The record showed that Janigan's statement was untrue. Early in the proceedings, Janigan admitted that there was in fact a "remarkable turn-around in operating results" at about the time of his purchase, but he said that the turn-around did not occur until after he bought the company. (Ex. 34, R. 1077; Ex. 14, R. 964-967; R. 48-50, 475-483). An analysis of the company's records was then made (R. 60-68) and established, as the trial court found, that when Janigan

made his statement to the directors the business of Besco "had actually developed into a condition of then unrealized but potentially large and immediate profit, prices in the industry having firmed and business on hand having doubled in the last three months and quintupled in the past year." (R. 857; Ex. 9, R. 949; Ex. 10, R. 952; Ex. 11, R. 953; Ex. 12, R. 955; Ex. 16, R. 973; Pltffs. Chalks 1, R.A. 1; 2, R.A. 2; 4, R.A. 4). The trial court found that Janigan knew these facts but concealed them. (R. 856-857).

The trial court further found that in the period preceding his statement to the directors Janigan had altered the books of the company. These books showed losses in October and November of 1955, just preceding the meeting of December 27, and the trial court found, based upon evidence, that a deliberate change in the inventory figure for these months had operated to decrease the profits which would otherwise have been shown. (R. 858-859, 251-257, 273-313, 347-356, 365-367, 461-471; Ex. 4, R. 943; Ex. 5, R. 945; Ex. 21, R. 1021; Ex. 22, R. 1023; Ex. 24, R. 1035; Ex. 25, R. 1039; Ex. 26, R. 1045). The trial court found that the alteration in the books was made "by or under the supervision of the defendant for the purpose of worsening the profit picture for the months involved." (R. 859).

Following the vote of December 27 the directors transmitted the offer to the stockholders and reported that in their opinion it was fair. Thereafter most of the stockholders accepted the offer, and as to them the transaction was consummated early in January, 1956. (R. 37-38, 40-44, 50-51).

On the basis of representations similar to those made to the directors, Janigan in January and February of 1956 acquired the remaining outstanding shares. (R. 668, 670, 1081, 1082).

The "turn-around" which Janigan admitted but in his testimony postponed in relation to the time of its occur-

rence, ripened into a trend which by the end of 1957 had increased the working capital of the company from less than $100,000 to more than $300,000, with regular and continuous monthly profits. (R. 935-942). In late 1957 he sold the company for $700,000.

A chart in the record at page 1125 shows that the purchase by Janigan of the company stock took place just following the "turn-around" between a long down-trend and a long rise. This same chart together with basic data given on page 1123 shows that during the period of Janigan's ownership virtually no new equipment was acquired nor other significant investment made. Janigan further admitted that after his purchase of the company he had not as president of Boston Electro done anything to make the company profitable that he had not done before nor had he worked any harder. (R. 955).

The remedy granted below was based upon restitution of Janigan's profits from the $700,000 sale, with appropriate credits for non-participating plaintiffs, miscellaneous fees and expenses, and a bonus that would probably have been paid by the company to Janigan.

Summary of Argument

The present case is not an appropriate one for review by writ of certiorari.

The trial court made adequate findings of fact and the Court of Appeals correctly interpreted the opinion in which these findings appeared.

Given the findings of the trial court, there was liability as a matter of law. The plaintiffs' case was that Janigan abused his position as a trusted insider by misstating the condition of the business that he was offering to buy and by a related alteration of the corporate books. This was a violation of the standards of conduct imposed by the

Securities Exchange Act of 1934 and by Rule 10b-5 promulgated thereunder.

There is nothing novel in the ruling of law that the defendant should be required to restore to the plaintiffs the profits which he made from the fraudulent transaction. These profits accrued from Janigan's sale of the company after its value had become inflated by the trend in company affairs whose initial stages Janigan had concealed from the directors.

In the present case the plaintiffs brought their action within less than a year after receiving ground for belief that Janigan had defrauded them. The suit was timely. There is abundant authority that in such circumstances the statute of limitations does not run until notice of the fraud is received.

Respondents' argument follows the order of the argument in the petition.

Argument

I. The Trial Court Made Adequate Findings of Fact and the Court of Appeals Correctly Interpreted the Opinion in Which These Findings Appear.

In Section I of its argument petitioner complains about the findings of the trial court and about the standards applied by the Court of Appeals in relation to those findings.

A. *The Finding of Reliance.*

Petitioner claims first that the Court of Appeals erred in construing the District Court's opinion to mean that a finding of "reliance" had been made.

Petitioner's contention is erroneous because it is clear

that the District Court did find reliance. There was explicit evidence of reliance (R. 114-115, 140, 214, 234, 238, 240, 244, 668, 670, 711-713, 734-735, 749, 756, 762, 1081-1085), an illustrative excerpt being as follows:

> "Q. Did you rely on what Mr. Janigan told you in making up your mind to sell? A. I did." (R. 670).

The opinion of the trial court shows that it believed this evidence. The opinion recites the contention of plaintiffs that they sold "on [Janigan's] representation" (R. 855), and the court then finds that Janigan made this false representation because of a "tendency to bring about the acceptance by the Board of the offer which he had just submitted." (R. 857). The opinion finds that plaintiffs have "sustained the burden of proving their case." (R. 859). Just before this finding the court refers to certain manipulations of the corporate books that were intended to have effect "if plaintiffs went beyond *reliance* on [Janigan's] untruthful answer to Bergen's question" and sought to see the books themselves. (R. 859, emphasis supplied).

As stated by the Court of Appeals:

> "We think it fairly and adequately implicit in the court's findings, in toto, that it found reliance upon the representation." 344 F.2d 781, 786.[1]

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[1] A footnote to the opinion of the Court of Appeals dealt with the stockholders who followed the recommendation of the Board of Directors and holds that an adequate finding of reliance by these persons was made. 344 F.2d 781. In this connection it is relevant that Janigan stipulated that all of such stockholders "would testify that he or she sold his stock as a result of the receipt of Mr. Bergen's letters to the stockholders at that time." (R. 762).

B. *The Finding as to Janigan's Knowledge.*

Petitioner's argument addresses itself (Petition, p. 14) to the paragraph from the opinion of the trial court in which the court states its disbelief of Janigan and finds that contrary to his denial he did know about the firming of prices and increase in backlog. Petitioner complains because the Court of Appeals interpreted this statement not as a finding based on disbelief but rather

> "as a roundabout way of saying that the evidence of the material facts, and of defendant's access thereto and connection therewith, was such that it would infer full knowledge on defendant's part unless it believed his profession of ignorance, and that not so believing, this inference controlled." 344 F.2d 781, 785.

The interpretation by the Court of Appeals was correct. The evidence at the trial included both basic records of the company's operations and also proof of Janigan's access to information of this kind, and these materials tended to show fraud by Janigan unless he could rebut the inference with a credible explanation. (Ex. 1, R. 869; Ex. 1A, R. 924; Ex. 2, R. 935; Ex. 3, R. 939; Ex. 9, R. 949; Ex. 10, R. 952; Ex. 11, R. 953; Ex. 12, R. 955; Ex. 16, R. 973; Chalks 1, R.A. 1; 2, R.A. 2; 4, R.A. 4; R. 255-272, 997-1020, 422-433; 373-380, 442; Ex. 19, unprinted). Janigan failed to rebut the adverse inference because his testimony shifted from place to place and was not credible.

Janigan first took the position that the turn-around which occurred to his good fortune did not occur until after he bought the company and that at the time of his purchase there was no backlog of orders. (R. 964-967, 475-483). Later, after the backlog studies were made, he urged that the existence of backlog was meaningless unless compared

with backlog at an earlier period. (R. 652). When further studies showed that backlog had doubled in a three-month period (Ex. 9, R. 949; Ex. 10, R. 952), he retreated to the feeble position that "the backlog of orders as that word is used is of no importance to a steel castings business" (R. 393), that there is no relation between sales and profits (R. 547-548), and that he did not see any significance in the data relied upon by plaintiffs. (R. 630-632).

Since Janigan was found to be lying about his state of mind it was necessary to accept the *prima facie* case of the plaintiffs, which was that Janigan did have knowledge of what the company books and records showed and that his failure to disclose that knowledge was fraud.

II. There Is No Conflict Among the Circuits in Relation to the Issue of Reliance.

Section II of petitioner's argument claims a conflict as to the issue of reliance between the case at bar and *List* v. *Fashion Park, Inc.*, 340 F.2d 457 (2d Cir. 1965), pet'n for cert. filed sub nom *List* v. *Lerner*, March 30, 1965.

Petitioner suggests that there could have been no reliance by plaintiffs because the statement by Janigan upon which liability was predicated came at the end of a meeting of the directors and was in some way not germane to the action which the directors took. Janigan did not testify to this effect, and the suggestion is contradicted by an examination of the testimony. (R. 88-92, 138-139, 195-196, 474, 480-481, 499, 609, 708-709, 732-734, 755, 962). In any event, the meeting at which Janigan's statement was made to the directors was followed by other transactions in which Janigan participated and which culminated in the sale of the stock not only to the directors but to many other stockholders. (R. 33-44, 47-52). Finally, the *List* opinion, while holding on that record that there had been no reliance,

stated plainly in an elaborate dictum that there can be reliance even if the defendant is silent; the test established by *List* is whether or not the aggrieved party would have acted "differently than he did act if the defendant had disclosed to him the undisclosed fact." 340 F.2d 457, 463. In the case at bar the trial court found that had plaintiffs known the undisclosed truth they would not have sold their stock. (R. 855-860).[2]

III. The Courts Below Correctly Ruled that in the Circumstances Presented by the Case at Bar Limitations Are Tolled Until the Fraud is Discovered.

Section III of petitioner's argument relates to the statute of limitations.

The record affirmatively shows that after the sale of the company by the stockholders to Janigan the first notice to the stockholders that they had been defrauded came when Janigan told one of the former directors to "hold onto your chair" and that he had sold the company for $700,000. (R. 94-95, 107, 197-199, 202, 234, 240, 244, 670, 735-738, 748, 756-757). The complaint was filed within a year from this communication.

The Massachusetts statute of limitations applies to causes of action such as the case at bar and also provides for the tolling of the statute in the event of fraudulent concealment. (G. L. c. 260, §§ 2A, 12). As pointed out by the Court of Appeals below (344 F.2d 781, 784), there is an open question whether the effect of the Securities Ex-

[2] Section II of petitioner's argument further questions whether the directors could rely upon Janigan when the omitted information was "available" to them, but there is no evidence that the directors had access to information as extensive as that possessed by the president of the company, and it is in any event no defense to a fraud case that a director must go beyond the trusted president of his company to determine whether or not the president is being truthful.

change Act of 1934 is to establish new fiduciary relationships on the part of insiders like Janigan so as to toll limitations under these provisions of the Massachusetts statutes and cases decided thereunder such as *Stetson* v. *French*, 321 Mass. 195 (1947) and *Old Dominion Copper Mining & Smelting Co.* v. *Bigelow*, 203 Mass. 159 (1909).

This undetermined question of state law is, as the Court of Appeals stated, unnecessary to decide because it is long established federal law that where fraud is involved the cause of action does not arise until discovery. 344 F.2d 781, 784. *Bailey* v. *Glover*, 21 Wall. 342 (1875); *Traer* v. *Clews*, 115 U.S. 528 (1885); *Holmberg* v. *Armbrecht*, 327 U.S. 392 (1946).

Petitioner asserts (Petition, p. 20) that the case at bar is an action at law so as to render distinguishable the federal equity cases cited above. There is no basis for this assertion. The complaint charged fraud and asked for an accounting, and this is what the trial court and the Court of Appeals have granted. Fraud and accounting are equitable concepts.

There is in any event authority that the same doctrine applies where any federally created right is being enforced in a federal court. *Winkler-Koch Engineering Co.* v. *Universal Oil Products Co.*, 100 F. Supp. 15 (S.D.N.Y. 1951); *Moviecolor Ltd.* v. *Eastman Kodak Co.*, 288 F.2d 80 (2d Cir. 1961), cert. denied 368 U.S. 821 (1961).[3]

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[3] Petitioner urges that the federal equity doctrine is at odds with Section 18(c) of the Securities Exchange Act of 1934, which limits certain causes of action to those which are brought one year after the discovery of facts constituting the cause of action. Assuming that such a conflict existed or was relevant, it has no application to the facts in the case at bar, where the action was brought within such one-year period.

IV. There Is No Conflict Among the Circuits in Relation to the Standards of Conduct Imposed by the Securities Exchange Act.

Section IV of petitioner's argument alleges a conflict between the case at bar and cases in two other circuits in relation to the standards of conduct imposed by Section 10b of the Securities Exchange Act and by Rule 10b-5.

The cases as to which conflict is claimed are *List* v. *Fashion Park, Inc.*, 340 F.2d 457 (2d Cir. 1965), pet'n for cert. filed sub nom *List* v. *Lerner*, March 30, 1965; *Kohler* v. *Kohler Co.*, 319 F.2d 634 (7th Cir. 1963); and *James Blackstone Memorial Library Ass'n* v. *Gulf, Mobile and Ohio R.R. Co.*, 264 F.2d 445 (7th Cir. 1959), cert. den. 361 U.S. 815 (1959). These cases are cited for the proposition that "facts which have only a speculative relationship to the future value of the security are not material." (Petition, p. 22).

There is no conflict between the case at bar and the cases cited because in the case at bar the fraud was in no way speculative or of merely future significance. Rather there was a plain misstatement which related to current orders on hand, to current prices, and to latent unrealized profits. These matters had a bearing upon the company's future, but they were plain, present facts. The manipulation of the corporate books for the purpose of suppressing apparent profit by the company is a further factor distinguishing the case at bar from cases in which liability was sought to be predicated upon some basis other than present, direct, material fraud.

In *Kohler* v. *Kohler Co.*, 319 F.2d 634 (7th Cir. 1963) the parties negotiated the price of the sale upon the basis of accounting information submitted through a national accounting firm. The alleged fraud involved the claimed withholding of information said to be necessary to make an

appraisal of the value of the stock, for example, the accounting treatment of certain aspects of the corporate pension plan, although it was admitted that extensive statistical data submitted to plaintiff for the purpose of the appraisal had been accurate as far as those data went. The court held that defendants had been under no duty to supply the various additional details later insisted upon by the plaintiff.

List v. *Fashion Park, Inc.*, 340 F.2d 475 (2d Cir. 1965), pet'n for cert. filed sub nom *List* v. *Lerner*, March 30, 1965, related to a claimed obligation to disclose the possibility of a future sale or merger of the company. The court held that the prospects of sale or merger were so remote as not to require disclosure.

In *James Blackstone Memorial Library Ass'n* v. *Gulf, Mobile and Ohio R.R. Co.*, 264 F.2d 445 (7th Cir. 1959), minority stockholders brought suit against the purchasing majority stockholder for failing to disclose the status of negotiations for a sale of the assets. The court denied recovery on several grounds, one of which was that the plaintiff-stockholders would not have received any advantage from the undisclosed sale because of an expressed restriction upon dividends payable to them. Such a restriction was absent in the case at bar and also in *Transamerica Corp.* v. *Speed*, 235 F.2d 369 (3d Cir. 1956), relied upon here by plaintiffs and which the Court of Appeals in the *Blackstone* case itself distinguished at page 453 of its opinion.

V. There Is No Conflict Among the Circuits Concerning the Correctness of the Remedy Granted by the Courts Below.

The last section of petitioner's argument relates to the remedy applied by the courts below, requiring Janigan to

account to the stockholders for the profit which he had made on the Boston Electro transaction. Conflict with the Tenth Circuit decision in *Estate Counseling Service* v. *Merrill Lynch, Pierce, Fenner & Smith,* 303 F.2d 527 (10th Cir. 1962) is claimed.

The remedy applied by the trial court and affirmed by the Court of Appeals was correct. The record shows, and the ultimate finding by the trial court in substance was, that the profit ultimately derived by Janigan from his sale of Boston Electro was the culmination of the up-trend which was in effect and was known to Janigan prior to his offer of December 27, 1955. (Ex. 34, R. 1077; Ex. 2, R. 935; Ex. 3, R. 939; Ex. 13, R. 955; Ex. 38, R. 1123; Ex. 39, R. 1124; R. 862-864).

This point is illustrated in the graph set forth in the record at page 1125. The lines on this chart show that it was the trend concealed by Mr. Janigan which ultimately produced the accumulated profits of 1957 and that what Janigan eventually sold was in substantial part cash. His gain thus grew directly from his wrongdoing.

Petitioner claims that plaintiffs should be limited to the damages which they can prove as of the date of the fraudulent misrepresentation. This would not be fair. The stockholders should not be obliged to go beyond proof that there was in fact fraud and to sustain the burden of showing the relation of each such aspect of the fraud to the value of the stock at that time. In any event, the plaintiffs swore, and the trial court believed, that had the plaintiffs known the truth they would not have sold their stock. It is hard to imagine any other conclusion. Had a director been told by the president that the business had recently doubled, he could hardly have voted to let the president buy the company. An expert witness produced by the defendant at the trial on remedy testified upon cross examination that his

advice to the directors had he known the facts would have been to "hold on and see what happened." (R. 823-824).

There is precedent for the accounting remedy which was granted.

As stated by the Court of Appeals in the case at bar (344 F.2d 781, 786), "it is simple equity that a wrongdoer should disgorge his fraudulent enrichment. *Falk* v. *Hoffman*, 1922, 233 N.Y. 199, 135 N.E. 243 (per Cardozo, J.); 4 Scott, Trusts §§ 507, 508, 508.1 (2d ed. 1956); Restatement, Restitution §§ 151, 202, Comments b, c (1937); See *Dickson* v. *Patterson*, 1896, 160 U.S. 584, 16 S.Ct. 373, 40 L.Ed. 543; cf. *Speed* v. *Transamerica Corporation*, D.C.D. Del., 1955, 135 F. Supp. 176, 186-193; modified on other grounds, 3 Cir., 1956, 235 F.2d 369; *Kardon* v. *National Gypsum Co.*, D.C.E.D. Pa., 1947, 73 F. Supp. 798, modified, 83 F. Supp. 613."

The federal rule is stated in *Speed* v. *Transamerica Corp.*, 135 F. Supp. 176, 186 (D. Del. 1955); affirmed on this point at 235 F.2d 369 (3d Cir. 1956):

> "It is unlawful for an insider, such as a majority stockholder, to purchase the stock of minority stockholders without disclosing material facts affecting the value of the stock, known to the majority stockholder by virtue of his inside position but not known to the selling minority stockholders, which information would have affected the judgment of the sellers. The duty of disclosure stems from the necessity of preventing a corporate insider from utilizing his position to take unfair advantage of the uninformed minority stockholders.
>
> "In this particular relationship, the injured party is not held within the limitations of the difference between price received and fair value of article sold. The injured party is entitled to require the perpetrator

> to disgorge gains made at the expense of the injured. . . . Some courts have called this a fiduciary duty while others state it is a duty imposed by the 'special circumstances.' ".

The *Speed* case held that the defrauded shareholder was not limited to the damages that he could prove as of the date of the fraud.

There is no conflict between the case at bar and *Estate Counseling Service* v. *Merrill Lynch, Pierce, Fenner & Smith*, 303 F.2d 527 (10th Cir. 1962). In that case securities purchased from defendant broker declined in value and plaintiff offered rescission, but this was refused by the broker. The buyer then brought an action for the profits which the defendant had led him to think he would make. The buyer had apparently not paid for the stock. The Tenth Circuit upheld the granting of defendant's motion for summary judgment on the theory that plaintiff's election to rescind precluded a later action for damages. The court discussed damages under Section 10b of the Securities Exchange Act of 1934, noting that although plaintiff is entitled to such "damages as naturally and proximately result from the fraud," he is not entitled to "the expectant fruits of an unrealized speculation." 303 F.2d at 533. This language, of course, is in no way at variance with the theory of recovery advanced herein. Here, the dishonest buyer actually made a large profit as the result of his fraud, and it is that which he is being required to disgorge.

United States v. *Bitter Root Development Co.*, 200 U.S. 451 (1906) is in no way inconsistent with the result below. There a purported bill in equity was brought by the United States following the wrongful cutting and disposition of timber. The Supreme Court held that the "liberal use in the bill" of averments "in regard to fraud, conspiracy and violation of trust," did not cause the action to be anything

other than an "action of trespass or trover to recover damages." 200 U.S. 451, 471-472. The case was accordingly dismissed on the ground that the equity court had no jurisdiction.

Conclusion

The judgment below having resulted from the application of well-established legal principles to evidence that was peculiar to the case at bar, no review by the United States Supreme Court is appropriate and the petition for writ of certiorari should be denied.

Respectfully submitted,

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